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PP RUEHIK
DE RUEHVB #0066 0291449
ZNR UUUUU ZZH
P 291449Z JAN 10
FM AMEMBASSY ZAGREB
TO RUEHC/SECSTATE WASHDC PRIORITY 9866
INFO RUEHZL/EUROPEAN POLITICAL COLLECTIVE PRIORITY
RUEATRS/DEPT OF TREASURY WASHDC PRIORITY
RUCPDOG/DEPT OF COMMERCE WASHDC PRIORITY
RUEAIIA/CIA WASHDC PRIORITY

UNCLAS ZAGREB 000066

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SENSITIVE

PASS TO EUR/SCE, TREASURY FOR INT'L AFFAIRS LARRY NORTON

E.O. 12958: N/A
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SUBJECT: CROATIA ANNOUNCES BAILOUT FUND PLAN FOR STRUGGLING
ENTERPRISES

¶1. (SBU) SUMMARY: Prime Minister Kosor announced a much-anticipated crisis financing initiative for struggling enterprises on January 28. This "bailout" plan is the first major initiative of an economic strategy to fight the recession, and has already received the support of the opposition SDP. Executive Director of the Croatian Bank for Reconstruction and Development (HBOR) Branimir Berkovic outlined for us the GoC's plan for its \$4.5 billion bailout fund for companies impacted by the economic crisis in a January 27 meeting. He explained that the fund will be financed through a combination of \$2 billion from the Croatian National Bank (HNB) and either a GoC-backed bond or capital fund. The bailout fund will be managed by private commercial banks in Croatia. Berkovic believes the central role of commercial banks in managing the funds will minimize the risk that they could be allocated on political criteria, or simply as additional subsidies to failing enterprises. END SUMMARY

¶2. (SBU) On February 11 the GoC will publicly announce the model and procedures for a \$4.5 billion (22 billion Croatian kuna, HNK) economic bailout fund for small-to-medium enterprises (SMEs) weakened by the recent economic crisis, according to Branimir Berkovic, Senior Executive Director of the Croatian Bank for Reconstruction and Development (HBOR). He explained that liquidity problems are becoming acute in many sectors of the economy, and commercial banks have been reluctant to issue new credit, especially to SMEs. He said HBOR attempted to provide emergency short term loans to SMEs last November, but these measures were not enough to have a significant impact on the situation. (Note: Anecdotally, we heard from commercial bank analysts that these loans were underutilized because of slow bureaucracy in the application process.)

¶3. (SBU) The current plan is for the Croatian National Bank (HNB) to release 3% of banks' reserves for the bailout fund, or roughly \$400 million (2 billion HNK), according to HNB Governor Zeljko Rohatinski. The rest of the remaining 2.5 billion kuna will be raised through either private investment funds or a bond issue with GoC guarantee. The current plan will be to issue a public tender for private banks to bid on fund money to be used for commercial loans. Berkovic told us that the HBOR is still working on the model for the loans, but that he hopes the loans will be available for SMEs at a tiered rate of 2-4-6% depending on a SMEs assets and liabilities. (NOTE: He added that SMEs of 'special state interest' or those involved with export businesses responsible for bringing foreign currency into Croatia will be eligible for the 2 percent rate.) The current commercial loan rate is around 10 percent in Croatia, and Berkovic mentioned that he was having some difficulty in persuading the private banks to participate in an effort they see as having little profit potential.

¶4. (SBU) Addressing SME eligibility, Berkovic told us that SMEs will have to qualify with commercial banks for these funds, which will maintain a higher standard for lending than if the loan program was implemented through a state-owned bank. He said foreign owned SMEs registered in Croatia will likely be eligible for the funds as well as some state-owned enterprises (SOEs). But Berkovic noted that the loans will be targeted at production enterprises rather than retailers. Berkovic predicted that the funds will be available in the market for lending approximately three weeks after the GoC's expected announcement on February 11. This delay will permit the GoC to prepare required legislation needed for the fund, to ensure EU compliance, and to draft an agreement between HBOR and the commercial banks that will implement the loans.

¶5. (SBU) COMMENT: It appears that this fund is a sincere attempt to help restart the economy and not merely a scheme to continue channeling state funds to failing state enterprises. It is also encouraging that the plan has received the support, if lukewarm, from the opposition. The next big economic test for the government comes in mid-February, with the latest attempt to privatize Croatia's shipyards. If that effort is successful, and if these bailout funds work as planned to stimulate business activity, then the government will have created some real economic policy momentum and could even silence a few of the critics who have accused the Kosor government of doing nothing substantive to help bolster Croatia's faltering economy. END COMMENT.

WALKER